



**STATE INVESTMENT BOARD
BOARD ADOPTED POLICIES**

POLICY NUMBER: 2.25.100

EFFECTIVE DATE: 3/21/02

TITLE: Permanent Funds' Portfolios

SUPERSEDES: 9/16/99

BOARD ADOPTION: 3/21/02

APPROVED:

A handwritten signature in black ink, appearing to read "James Brueckner", is written over the word "APPROVED".

PURPOSE:

This document outlines the State Investment Board's (SIB) investment policy and guidelines for the permanent funds and supersedes any prior Board-adopted policies.

These guidelines allow for sufficient flexibility in the management process to capture investment opportunities, while providing parameters that ensure prudence and care in the execution of the investment program for permanent funds.

The following permanent funds are invested by the SIB:

- Agriculture Permanent Account
- Millersylvania Park Trust Account
- Normal School Permanent Account
- Permanent Common School Account
- Scientific Permanent Account
- State University Permanent Account

A full description of each fund, including the specific asset allocation and performance benchmark, is listed in Addendum A.

POLICY:

Standard of Care

Under RCW 43.33A.030, trusteeship of the state's permanent funds is vested in the voting members of the Board. The Legislature has established a standard of care for investment of these funds in RCW 43.33A.140. Additionally, the Board and its staff must comply with other state laws, such as the Ethics in Public Service Act, Chapter 42.52 RCW, as it makes its investment decisions and seeks to meet the investment objectives listed below.

Strategic Objective

The strategic objectives for the permanent funds' portfolios are:

The permanent funds' investments are to be managed to achieve the highest return possible consistent with the desire to emphasize high current yield to maturity opportunities and to add value through active management. The strategic objectives include:

1. Safety of principal
2. Current income
3. Long-term stability of purchasing power
4. Preservation of the public's trust

Taken together, these objectives imply portfolios for which growth keeps pace with inflation over time (preservation of capital), and that are able to provide a stable level of income sufficient to meet each fund's constituent needs.

Performance Objective

In most cases, the permanent funds' investments are to emphasize stability and maximize income to support the operations of each irreducible trust. The Permanent Common School Fund does have a small equity allocation which incorporates limited exposure to portfolio growth.

Within the required accounting guidelines, the permanent funds' portfolios are to be managed, so that their individual performance meets or exceeds the return of each fund's specific benchmark with a volatility of returns that, over time, is similar to or less than the benchmark's for a similar level of returns.

For the funds holding portfolios consisting of only fixed income, the performance benchmark is the Lehman Aggregate Index.

For funds holding both equity and fixed income, the performance benchmark shall be a combination of an equity index representative of the equity held in the fund and the Lehman Aggregate Index, in percentage allocations that represent the fund's target allocations.

The Board will measure both the book value income return and the marked-to-market total rate of return on the funds.

Risk Tolerance

Risk will be managed in a prudent manner. Since the stakeholder only receives the current income and net capital appreciation of the assets, the funds have a below average ability to tolerate volatility in current income.

Portfolio Constraints

- A. All assets under management by the SIB are to be invested to maximize return at a prudent level of risk in accordance with the requirements of statutes RCW 43.33A.110 and RCW 43.33A.140, which state, in part, that the SIB is to "...establish investment policies and procedures designed to attempt to limit fluctuations in industrial insurance premiums, and, subject to this purpose, to maximize return at a prudent level of risk."
- B. No corporate fixed income issue's cost shall exceed three percent of the fund's market value at the time of purchase, nor shall its market value exceed six percent of fund's market value at any time (RCW 43.33A.140).

Permissible Investments

- A. Any SIB managed fund that meets a fund's investment objectives and its permissible investments constraints.
- B. U.S. and non-U.S. public equity (only the Permanent Common School Fund has been constitutionally approved to hold equity, as of the date of this policy).
- C. Investment Grade Fixed Income:

Investment Grade is defined as rated Baa3 or higher by Moody's Investors Service.

Although fixed income securities that are rated below investment grade may not be purchased, portfolio holdings that are downgraded to those levels or are no longer rated may continue to be held.

Permissible Fixed Income Market Segments:

- 1. *U.S. Treasuries and Government Agencies.*
- 2. *Credit Bonds.*
- 3. *Mortgage Backed Securities.*
- 4. *Asset Backed Securities.*
- 5. *Commercial Backed Mortgage Securities.*
- 6. *Convertible Securities.*

7. *Eurodollar Bonds.*
8. *Non-Dollar Bonds.*

Other fixed income segments and instruments may be added from time to time as they are developed or deemed appropriate.

Sector Allocations

Portfolio allocations are to be managed within the ranges presented below. These targets are long-term in nature. Deviations may occur in the short-term as a result of interim market conditions; however, if a range is exceeded, the portfolio must be rebalanced to the target allocations, as soon as it is practical.

(The target allocations below are applicable to all irreducible trusts except Millersylvania Park Trust. The small size of this Trust's corpus precludes practical implementation.)

Target allocations for the Fixed Income Sectors:

| | <u>Range</u> |
|---|--------------|
| U.S. Treasuries and Government Agencies | 10 – 50% |
| Credit Bonds | 10 – 50% |
| Asset Backed Securities | 0 – 10% |
| Commercial Mortgage Backed Securities | 0 – 10% |
| Mortgage Backed Securities | 5 – 40% |
| Total Bonds | 100% |

Duration Target: The fixed income portfolio's duration is to be targeted within plus or minus 20 percent of the duration of the portfolio's performance benchmark, the Lehman Aggregate Index.

Reporting

- A. A management information system is to be used for reporting internally to senior staff on the implementation of this policy. This report is prepared monthly to include, but is not limited to:
 1. Current market values and allocations, by sector, compared to the index and the policy ranges;
 2. Aggregate and individual portfolio characteristics compared to guidelines; and,

3. Delinquencies and defaults.
- B. An executive management report is to be provided to the Board quarterly showing market values and performance.
- C. At minimum, annual reports on the asset allocation, income return, and trust status will be provided to stakeholders.

RESPONSIBILITIES:

State Investment Board - Responsible for approving the funds' strategic investment policy

Administrative Committee - Responsible for reviewing and recommending investment policy and asset allocation to the Board and for reviewing staff investment management guidelines.

Public Markets Committee - Responsible for reviewing and recommending the strategic policy to the Board, and for reviewing the structure, strategy, and performance of the funds.

Staff - Responsible for recommending an investment policy to the Public Markets Committee, for implementing the policy, and for reporting to the Public Markets Committees and to the Board.

TITLE: AGRICULTURAL PERMANENT FUND

NUMBER: 601

AUTHORITY: RCW 43.79.130

DESCRIPTION: This is a permanent and irreducible fund and moneys are invested in securities, the interest of which must be either invested or used exclusively for the use and support of the Agricultural College.

STAKEHOLDER: Washington State University

STATUTORY
REFERENCE: **43.79.130 Agricultural permanent fund.** There shall be in the state treasury a permanent and irreducible fund known as the "agricultural permanent fund," into which shall be paid all moneys derived from the sale of lands set apart by the enabling act or otherwise for an agricultural college. [1965 c 8 § 43.79.130.]

ASSET ALLOCATION: 100 percent Fixed Income

PERFORMANCE
BENCHMARK: Lehman Aggregate Index

CLASSIFICATION:
Fund Type: Nonexpendable Trust (HB)
Treasury Type: Treasury (1)
Budget Type: Nonappropriated/Nonallotted (N)

ROLL-UP FUND: Higher Education Endowment Fund (H5)

| | |
|---------------------------|---|
| TITLE: | MILLERSYLVANIA PARK TRUST ACCOUNT |
| NUMBER: | 603 |
| AUTHORITY: | Chapter 97, Laws of 1931 (not codified) |
| DESCRIPTION: | This is a permanent and irreducible fund. Interest, income and earnings thereof must be used for improvement, maintenance and upkeep of the Millersylvania State Park. |
| STAKEHOLDER: | Parks and Recreation Commission |
| STATUTORY REFERENCE: | Chapter 97 Laws of 1931 (not codified) established a permanent and irreducible fund in the state treasury entitled Millersylvania Park trust fund. Original source of funds from a gift of cash and securities. The gift also included land to be held for a park known as Millersylvania Memorial Park. |
| ASSET ALLOCATION: | 100 percent Short-Term Fixed Income |
| PERFORMANCE BENCHMARK: | 90-Day Treasury Bills |
| CLASSIFICATION: | |
| Fund Type: | Nonexpendable Trust (HB) |
| Treasury Type: | Treasury (1) |
| Budget Type: | Nonappropriated/Nonallotted (N) |
| ROLL-UP FUND: | Common School Permanent Fund (H6) |

TITLE: NORMAL SCHOOL PERMANENT ACCOUNT

NUMBER: 604

AUTHORITY: RCW 43.79.160

DESCRIPTION: This is a permanent and irreducible fund and all moneys are invested in securities. All interest earned from such investments must either be reinvested or used exclusively for the benefit of the normal school; i.e., Eastern Washington University, Western Washington University, Central Washington University, and The Evergreen State College.

STAKEHOLDERS: Eastern Washington University, Western Washington University, Central Washington University, and The Evergreen State College.

STATUTORY
REFERENCE: **43.79.160 Normal school permanent fund.** There shall be in the state treasury a permanent and irreducible fund known as the "normal school permanent fund," into which shall be paid all moneys derived from the sale of lands set apart by the enabling act or otherwise for state normal schools. [1965 c 8 § 43.79.160.]

ASSET ALLOCATION: 100 percent Fixed Income

PERFORMANCE
BENCHMARK: Lehman Aggregate

CLASSIFICATION:
Fund Type: Nonexpendable Trust (HB)
Treasury Type: Treasury (1)
Budget Type: Nonappropriated/Nonallotted (N)

ROLL-UP FUND: Higher Education Endowment Fund (H5)

TITLE: PERMANENT COMMON SCHOOL ACCOUNT

NUMBER: 605

AUTHORITY: State Constitution Article IX, Section 3

DESCRIPTION: This is a permanent and irreducible fund and all monies are invested in securities. Income derived from the fund primarily is used for support of the common schools. The citizens of Washington voted in 1966 to amend the state Constitution to allow this permanent fund to invest in other securities beyond fixed income.

STAKEHOLDER: Superintendent of Public Instruction for use by common schools.

**STATUTORY
REFERENCE:**

**ARTICLE IX
EDUCATION...**

§ 3 FUNDS FOR SUPPORT. The principal of the common school fund as the same existed on June 30, 1965, [certified by the State Treasurer to be a balance of \$100,778,224.20] shall remain permanent and irreducible. The said fund shall consist of the principal amount thereof existing on June 30, 1965, and such additions thereto as may be derived after June 30, 1965, from the following named sources, to wit: Appropriations and donations by the state to this fund; donations and bequests by individuals to the state or public for common schools; the proceeds of lands and other property which revert to the state by escheat and forfeiture; the proceeds of all property granted to the state when the purpose of the grant is not specified, or is uncertain; funds accumulated in the treasury of the state for the disbursement of which provision has not been made by law; the proceeds of the sale of stone, minerals, or property other than timber and other crops from school and state lands, other than those granted for specific purposes; all moneys received from persons appropriating stone, minerals, or property other than timber and other crops from school and state lands other than those granted for specific purposes, and all moneys other than rental recovered from persons trespassing on said lands; five per centum of the proceeds of

the sale of public lands lying within the state, which shall be sold by the United States subsequent to the admission of the state into the Union as approved by section 13 of the act of congress enabling the admission of the state into the Union; the principal of all funds arising from the sale of lands and other property which have been, and hereafter may be granted to the state for the support of common schools. The legislature may make further provisions for enlarging said fund.

There is hereby established the common school construction fund to be used exclusively for the purpose of financing the construction of facilities for the common schools. The sources of said fund shall be: (1) Those proceeds derived from the sale or appropriation of timber and other crops from school and state land subsequent to June 30, 1965, other than those granted for specific purposes; (2) the interest accruing on said permanent common school fund from and after July 1, 1967, together with all rentals and other revenues derived therefrom and from lands and other property devoted to the permanent common school fund from and after July 1, 1967; and (3) such other sources as the legislature may direct. That portion of the common school construction fund derived from interest on the permanent common school fund may be used to retire such bonds as may be authorized by law for the purpose of financing the construction of facilities for the common schools.

The interest accruing on the permanent common school fund together with all rentals and other revenues accruing thereto pursuant to subsection (2) of this section during the period after the effective date of this amendment and prior to July 1, 1967, shall be exclusively applied to the current use of the common schools.

To the extent that the moneys in the common school construction fund are in excess of the amount necessary to allow fulfillment of the purpose of said fund, the excess shall be available for deposit to the credit of the permanent common school fund or available for the current use of the common schools, as the legislature may direct. [AMENDMENT 43, 1965 ex.s. Senate Joint Resolution No. 22, part 1, p 2817. Approved November 8, 1966.]

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| | | |
|-------------------|------------------|--------------|
| ASSET ALLOCATION: | 0 – 30 percent | U.S. Equity |
| | 70 – 100 percent | Fixed Income |

PERFORMANCE
BENCHMARK:

A blend of the Wilshire 5000 index and Lehman Aggregate that matches the average equity/debt mix of the fund over the measurement time period.

CLASSIFICATION:

| | |
|----------------|---------------------------------|
| Fund Type: | Nonexpendable Trust (HB) |
| Treasury Type: | Treasury (1) |
| Budget Type: | Nonappropriated/Nonallotted (N) |

ROLL-UP FUND:

Common School Permanent Fund (H6)

TITLE: SCIENTIFIC PERMANENT ACCOUNT

NUMBER: 606

AUTHORITY: RCW 43.79.160

DESCRIPTION: This is a permanent and irreducible fund and all moneys are invested in securities. All interest earned from such investments must either be reinvested or used exclusively for the benefit of the scientific school located at the Washington State University.

STAKEHOLDER: Washington State University.

STATUTORY
REFERENCE: **43.79.110 Scientific permanent fund.** There shall be in the state treasury a permanent and irreducible fund known as the "scientific permanent fund," into which shall be paid all moneys derived from the sale of lands set apart by the enabling act or otherwise for a scientific school. [1965 c 8 § 43.79.110. Prior: 1901 c 81 § 4; RRS § 5526.]

ASSET ALLOCATION: 100 percent Fixed Income

PERFORMANCE
BENCHMARK: Lehman Aggregate Index

CLASSIFICATION:
Fund Type: Nonexpendable Trust (HB)
Treasury Type: Treasury (1)
Budget Type: Nonappropriated/Nonallotted (N)

ROLL-UP FUND: Higher Education Endowment Fund (H5)

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TITLE: STATE UNIVERSITY PERMANENT ACCOUNT

NUMBER: 607

AUTHORITY: RCW 43.79.060

DESCRIPTION: This is a permanent fund and all moneys are invested. All interest earned from such investments must either be reinvested or used exclusively for the benefit of the University of Washington.

STAKEHOLDER: University of Washington

STATUTORY REFERENCE: **43.79.060 University Permanent Fund.** There shall be in the state treasury a permanent and irreducible fund known as the "state university permanent fund," into which shall be paid all moneys derived from the sale of lands granted, held, or devoted to state university purposes. [1965 c 8 § 43.79.060. Prior: 1907 c 168 § 1; RRS § 5518.]

ASSET ALLOCATION: 100 percent Fixed Income

PERFORMANCE BENCHMARK: Lehman Aggregate Index

CLASSIFICATION:

| | |
|----------------|---------------------------------|
| Fund Type: | Nonexpendable Trust (HB) |
| Treasury Type: | Treasury (1) |
| Budget Type: | Nonappropriated/Nonallotted (N) |

ROLL-UP FUND: Higher Education Endowment Fund (H5)